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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Deployment Of Wireline Services Offering	)	CC Docket No. 98-147
Advanced Telecommunications Capability	)	

REPLY COMMENTS OF AT&T CORP.

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SUMMARY

Almost 90 parties have submitted comments, evidence, and studies to the Commission regarding the difficulties the industry will encounter as entrants attempt to accelerate advanced services deployment. Most of those comments provide substantial guidance as to how the Commission can promote the availability of ubiquitous, affordable advanced services.

Unfortunately, not all commenters chose to play a constructive role. In the NPRM, the Commission explicitly requested details on how it could augment its existing interconnection, unbundling, and collocation rules to accelerate advanced services deployment. Notwithstanding their control over virtually all of the relevant facilities and information – or, perhaps, because of it – the incumbent LECs have, for the most part, chosen to ignore that request. Instead, they repeat the same argument that the Commission and its state counterparts have rejected time and again as legally and factually baseless: that their local markets are "open" to competition and therefore no regulation of their conduct is required or allowed. The plain language of the Act, however, leaves no room for doubt that the Commission cannot grant the regulatory forbearance that the incumbents seek. Nor would such forbearance be sound policy even if it were not unlawful. As the Commission well knows, local markets are not open to competition and further Commission action to implement and enforce Section 251 of the Act is plainly necessary. AT&T's Reply Comments describe the broad consensus among non-ILEC commenters as to those measures the Commission has proposed that it should (and should not) implement.

In Section I, AT&T refutes the ILECs' arguments that: (i) despite their control over bottleneck facilities used to provide advanced services, incumbents have no advantage over entrants in the provision of those services; and (ii) implementation of the Act's interconnection, collocation, and unbundling requirements will eliminate ILEC incentives to investment in the new technology and advanced services. That incumbents have just begun offering advanced services does not mean that they lack market power. While entrants and, in response, incumbents just recently began deploying xDSL services, the ILECs own and control the bottleneck facilities their competitors require to reach potential customers – a classic source of market power. Further, by providing nondiscriminatory access to collocation space and network elements (as most commenters strongly support), the Commission will subject the ILECs to competitive pressures and encourage the deployment of advanced services. ILECs will deploy advanced services both to gain an advantage over their new competitors and to protect themselves against entrant innovations. On the other hand, if the Commission immunizes ILECs from CLEC competition by failing to promulgate rules promoting nondiscriminatory access to collocation space and network elements, the ILECs will remain free to continue to protect their existing ISDN, T1, and residential second line offerings by retarding advanced services deployment and will provide advanced services only where other competitive pressures emerge.

Moreover, entrants' incentives to deploy facilities supporting advanced services will be augmented as well. Entrants already have strong incentives to break their dependency on their competitors. The proposed collocation and unbundling requirements will promote that process by allowing them to build a customer base from which entrants can justify additional

facilities deployment. Further, in those instances where entrants do lease the network elements necessary to provide advanced services, the ILECs will receive full compensation, including a risk-adjusted rate of return on their investments.

In Section II, AT&T discusses the overwhelming opposition to the Commission's proposed separate affiliate regime. The vast majority of commenters conclude that the NPRM's proposed separation requirements are wholly insufficient to justify a finding that the ILECs' advanced services affiliates would be non-ILECs under Section 251(h). A central purpose of the "successor or assign" provision in Section 251(h) plainly is to bar ILECs from evading their obligations under Section 251(c) through a "corporate shell game." Thus, many commenters, including state commissions, rightly express great concern that the NPRM proposal will encourage ILECs to transfer facilities and investments so as to evade their resale and unbundling obligations.

A significant majority of commenters also conclude that the separation obligations under Section 272 are wholly insufficient to justify deeming an affiliate a non-ILEC under Section 251(h), because they do not prevent ILECs and their affiliates from engaging in concerted anticompetitive conduct. Section 272 cannot protect competition where the ILEC still maintains monopoly control over bottleneck facilities. Hence, commenters broadly call on the Commission to take a number of prophylactic measures as part of any separate-affiliate regime. As an initial matter, the Commission should require that the ILECs and their advanced services affiliates, before they begin providing advanced services, establish that they have and will comply with all separation and disclosure obligations imposed by the Commission. Commenters

also recommend that, in light of the importance independent equity ownership plays in preserving truly independent action, the Commission should mandate outside ownership of the separate affiliate of the range of 20 percent to over 50 percent. Moreover, many commenters agree that the separate affiliate should be barred from providing advanced services through resale in order to reduce the opportunity for the ILEC and its affiliate to engage in a classic price squeeze and, for related reasons, they overwhelmingly condemn the NPRM's proposal to allow ILECs to make "de minimis" transfers of advanced services facilities to the affiliate without the affiliate being considered an assign.

Numerous commentators further conclude that an advanced services affiliate should be barred from using the ILEC brand. Indeed, it is axiomatic that an ILEC affiliate cannot be deemed to "function[] just like any other competitive LEC,"[1] if it comes to the market clothed in ILEC's brand. Nor can ILEC affiliates be considered truly separate of the ILEC unless they are prohibited from engaging in joint marketing and are not allowed discriminatory access to the ILECs' CPNI, because such opportunities cannot realistically be extended to nonaffiliated CLECs. By the same token, insofar as an ILEC advanced services affiliate obtains the right to access intellectual property embedded in a UNE, CLECs necessarily must be able to obtain that UNE on the same terms and conditions. Finally, a number of commenters rightly conclude that small ILECs should be subject to the same separation requirements as the large ILECs.

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1 NPRM, ¶ 92.

Section III discusses the nearly universal agreement that access to unbundled loops is essential to advanced services competition. The comments leave no room for doubt that unbundling basic, xDSL capable, and xDSL equipped loops is technically feasible and will broaden the advanced services availability. The Commission also should act aggressively to promote entrant access to DLC and other loops passing through remote terminals. Commenters generally agree that these loop configurations present space and technical difficulties, but those problems can be overcome through loop grooming and other network modifications. More importantly, if the Commission adopts the rules proposed by AT&T and other commenters, ILECs will have greater incentives going forward to build remote terminals, configure their loops, and deploy new DLC technologies in such a manner that today's problems will be largely eliminated tomorrow. In addition, almost all commenters, including many ILECs, agree that advanced services competition will require incumbents to provide more information through their OSS and otherwise make their loop data available on a nondiscriminatory basis. And in order to prevent ILECs from using spectrum management as a strategic tool to deter entry, the Commission should convene an industry forum to establish guidelines regarding the nondiscriminatory application of industry spectrum management standards.

Section IV discusses the extraordinary difficulties commenters have experienced in obtaining physical collocation space in ILEC central offices and the Commission's clear authority to remedy many of these problems by promulgating additional national collocation rules. To that end, commenters believe that the Commission should explicitly require ILECs to permit Remote Switching Module and packet switching collocation as well as other equipment

useful in providing voice and advanced services. ILECs have failed to present any legitimate justification for prohibiting such collocation. Commenters also generally agree that "cageless" collocation, shared collocation, the removal of equipment no longer used and useful, and the elimination of "POTS Bays" will promote more efficient use of scare collocation space. By contrast, virtual collocation is an inferior alternative to "cageless" collocation because it may: (i) deprive CLECs of access to their equipment; (ii) result in inexperienced ILEC technicians attempting to maintain the equipment; and, (iii) produce unacceptably long repair intervals when emergency repairs are required.

Sections V, VI, and VII confirm that most parties to this proceeding agree with AT&T that: (i) the Commission should not weaken its unbundling rules by changing its classifications of various facilities that it has previously held are network elements under Section 251(c)(3); (ii) the proposed "targeted" interLATA relief would subvert Section 271, violate Section 10(d), diminish ILEC incentives to open their local markets, and create an administrative nightmare for the Commission; and, (iii) under the plain language of Section 251(c)(4) ILECs' advanced service offerings are subject to the resale obligation because they are "telecommunications service[s] that the [ILEC] provides at retail to subscribers who are not telecommunications carriers[.]"

Finally, Section VIII discusses the heightened need for access charge reform created by the increasing availability of advanced services to residences and small business. As MGC Communications demonstrates, these bloated charges already have created serious market distortions. In particular, they create an artificially high incentive for carriers to deploy phone-

to-phone IP service facilities. At the same time, IP voice and data applications promise to customers around the country a wide array of attractive new services. The Commission, then, should not penalize innovative carriers like AT&T, Qwest, IDT, and ICG who have begun offering phone-to-phone IP service by imposing on those services inflated, subsidy-laden access charges. Instead, the Commission should promote the interests of all consumers by immediately acting on the petitions currently before it and reducing access charges to competitive levels.

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REPLY COMMENTS OF AT&T CORP.

Pursuant to the Revised Public Notice released on August 12, 1998, AT&T Corp. ("AT&T") respectfully submits these reply comments on the Commission's Notice of Proposed Rulemaking ("NPRM") regarding rules the Commission may adopt to encourage competition in, and timely deployment of, advanced telecommunications capabilities.[2]

INTRODUCTION

In the NPRM the Commission requested the specific data and proposals needed to ensure that its national interconnection, collocation and unbundling standards provide the nondiscriminatory access to network facilities required by the Act and promote real competition in the provision of advanced services over those facilities. As the Commission has recognized, the availability of these new services in a competitive environment promises enormous benefits to all consumers. Notwithstanding their control over virtually all of the relevant facilities and

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[2] A list of the commenters and the abbreviations used for them in these reply comments is attached as an Appendix.

information – or, perhaps, because of it – the incumbent LECs have, for the most part, chosen to ignore that request.

The incumbents propose no solutions to the hurdles currently limiting entrant access to remote terminals; they do not even supply the data that might allow others to come up with solutions. Instead, they propose denying their potential competitors access to loops at remote terminals. The incumbents do not disclose the loop characteristic information that is in their possession; rather, they oppose any expansion of existing OSS requirements as "burdensome." And incumbents do not discuss methods of deploying xDSL services to customers served over IDLC configured loops. They simply proclaim that it cannot be done.

Instead of making a constructive contribution to this proceeding, the incumbents raise the same legally and factually bankrupt flag that they have flown in every regulatory proceeding since the passage of the Act: that their local markets are "open" to competition and therefore no regulation of their conduct is required (or, indeed, allowed). The reality is quite different, and the incumbents' comments cannot be taken seriously. As an initial matter, the regulation the incumbents seek to evade is mandated by the plain terms of the Act. In all events, the incumbents' own conduct over the past three years conclusively demonstrates that they can and will exploit any opportunity to impede competition, and that strong pro-competition national rules are therefore imperative. As MCI WorldCom (p. 70) aptly notes, "[n]othing has contributed more to the failure of facilities-based local competition to develop since the passage of the Act than the ILECs' refusal to comply with their statutory obligation to provide reasonable, nondiscriminatory, and cost-based unbundled access to the local loop, including

related OSS." Absent Commission rules that clearly and directly require nondiscriminatory access to the local facilities used to provide advanced services, the same anticompetitive incumbent incentives and abilities can be expected to cripple the competitive provision of those services.

Fortunately, the many other participants in this proceeding have taken the NPRM seriously. And, as discussed below, these parties have reached a general consensus regarding the principal steps the Commission should take to implement the Act's requirements and promote advanced services. Regarding the separate affiliate proposal, the majority of commenters urge the Commission to read Section 251(h)(1) as it should be read – to bar ILECs from evading their obligations under Section 251(c) through a "corporate shell game." Moreover, a number of state commissions, conclude that the proposal would have the unintended effect of incenting ILECs and their affiliates to engage in concerted anticompetitive conduct and to shift network facilities and investments to the affiliate so as to evade the ILECs' unbundling and resale obligations under the Act, underscoring the fatal lack of detail concerning the types of facilities and services that may properly be controlled by the affiliate. Further, the affiliate discussed in the NPRM would nonetheless be subject to ILEC regulation as a "comparable carrier" under Section 251(h)(2).

If the Commission nonetheless determines to proceed with the separate affiliate approach, a broad array of comments, again including the majority of those submitted by state commissions, confirm that the safeguards required under Section 272 are entirely insufficient to limit both the ability and the incentive of ILECs and their affiliates to engage in concerted

anticompetitive conduct. They urge significant strengthening of the proposed separation requirements to ensure sufficient separation and operational independence of the affiliate from the ILEC so that it functions like any other CLEC and derives no anticompetitive and discriminatory advantages from the ILEC. Without these added requirements, the affiliate cannot properly be deemed truly separate from the ILEC such that it can lawfully be exempted from the unbundling and resale obligations of Section 251(c).

In particular, commenters widely call on the Commission to require (i) a prior approval process; (ii) a significant and meaningful amount of outside ownership of the affiliate so as to encourage the affiliate to act in its own corporate self interest rather than simply as an ILEC alter ego. In addition, commenters stress the need to enforce vigorously the nondiscrimination requirement, and, correspondingly, support a bar on the affiliate's use of the ILEC brand, joint marketing and discriminatory access to CPNI, and the affiliate's resale of ILEC services. Commenters also object strenuously to any transfers, de minimis or otherwise, of advanced services facilities to the affiliate.

There is also a strong consensus among non-ILEC comments regarding the rules the Commission should adopt regarding loops. These commenters agree that the Commission should ensure that entrants have nondiscriminatory access to basic, xDSL capable, and xDSL equipped loops, even if a loop must be conditioned or groomed to provide the requested service. Thus, the Commission should establish national rules that prohibit ILECs from impeding entrant access to those loop types and all their features, functions, and capabilities. The comments also demonstrate that the Commission should clarify and expand its existing OSS rules so that

entrants can determine what advanced services could be provided to a particular customer in the same manner that ILECs can make this determination. Further, the Commission should convene a forum to prevent the kind of discriminatory application of spectrum management standards that CLECs have already encountered. And because remote terminals create a strategic opportunity for ILECs to hide loops and discriminate against their potential competitors, the Commission should adopt rules that promote parity of access to remote terminals and the services that ILECs can offer using those facilities. As the demand for advanced services expands, ILECs will place increasing reliance on remote terminal configured loops to achieve higher quality service and transmission speeds. Consequently, in order to prevent ILECs from "hiding" local loops when a loop passes through a remote terminal by raising claims of space exhaustion or technical feasibility, the Commission should require ILECs to provide xDSL equipped loops and require the construction of new remote terminals to take into account the needs of CLECs for collocation.

The comments also evince broad agreement that the Commission has authority to and should expand its collocation rules. ILECs continue to unreasonably restrict access to and use of collocation space thereby significantly undermining local competition. As the comments indicate, these tactics have the potential to be even more devastating for competitive advanced service offerings than for basic services. Thus, most carriers and state commissions agree that the Commission should expand the types of equipment that can be collocated to include, inter alia, remote switching modules and packet switches. In light of rapid technological change, the Commission also should refrain from limiting permissible equipment to particular types of

technology. And many parties like AT&T demonstrated convincingly that the Commission should permit "cageless" collocation, eliminate of POTS Bays, and allow interconnection using copper cables. AT&T and other commenters further demonstrated that the Commission should promote the efficient and nondiscriminatory use of central office and remote terminal space by (i) requiring ILECs to remove equipment that is no longer used or useful, (ii) allowing CLECs who have been denied space to tour central offices and confirm that space is indeed not available, and (iii) limiting the amount of space that the ILEC's separate affiliate may occupy in a central office or remote terminal.

Finally, the incumbents again stand virtually alone in their requests for relief from existing interLATA restrictions, resale obligations, and unbundling requirements. The relief they request would violate the plain language of the Act and seriously undermine competition for advanced services. These requests should be denied.

I. INCUMBENT LECS HAVE BOTH INCENTIVES AND ABILITY TO IMPEDE COMPETITION FOR ADVANCED SERVICES.

Incumbents offer two reasons why the Commission should refrain from removing entry barriers to the widespread deployment of advanced services: (1) that despite their control over the bottleneck facilities used to provide advanced services, incumbents have no advantage over entrants in the provision of those services, and (2) that implementation of the Act's interconnection, collocation, and unbundling requirements will rob incumbents of their incentives to deploy new technologies and services. The first argument is refuted by the most basic principles of economic theory and by the record evidence – incumbents can and are using their control over the public network to thwart entrant attempts to offer advanced services. The

second argument has it exactly backwards. If the Commission follows through on its proposals to open local markets to competing advanced services providers, incumbents' incentives to deploy – which to date have been muted by concern over "cannibalization" of their other high margin monopoly retail services – will be significantly enhanced by the realization that if they do not deploy new electronics and services over the existing network, others will.

A. Incumbent LECs' Control Of Bottleneck Local Facilities Gives Them Significant Market Power Over the Provision Of Advanced Services.

Even aside from the fact that the Act's interconnection, collocation, and unbundling provisions apply by their terms to facilities used to provide advanced services, there is no legitimate economic rationale for excusing incumbents from their statutory obligations in this context. While the deployment of advanced services has only recently begun, the ILECs "still own and control the public network, they still have redoubtable market power, and they still have the expertise and the will to place countless obstacles in front of would-be competitors."[3]

The incumbents argue that because they have themselves just begun offering xDSL services, they do not have market power.[4] But this argument confuses market power with market share. Market power is a firm's ability to sustain prices above competitive levels,[5] and

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3 xDSL Networks, p. 3.

4 See, e.g., GTE, p. 3 ("ILECs . . . are the newest among a multitude of rivals in a vigorously competitive market."); BellSouth, p. 30 ("ILECs that provide DSL services do not possess market power in the advanced services market.").

5 See, e.g., American Tobacco Co. v. United States, 328 U.S. 781 (1946) ("the material consideration in determining whether a monopoly exists is not that prices are raised and

(footnote continued on following page)

both the courts and the Commission have long recognized that control of bottleneck facilities is direct evidence of market power, regardless of market share.[6] Indeed, as discussed infra (p. 10), the fact that many incumbents have only recently begun to offer advanced services over xDSL technology that have been available for years through modifications to their existing networks, if anything, confirms the existence of market power – a strategy of slow-rolling the implementation of new technologies that compete with existing high margin services is a hallmark of market power. That market power will persist so long as incumbents can inhibit their potential competitors' access to the network facilities used to provide xDSL services.

GTE (p. 3) responds that "[t]he advanced services marketplace is vigorously competitive and does not rely on ILEC telephone networks for essential inputs." GTE points to cable facilities.[7] The reality, however, is that GTE and other incumbents control the only

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(footnote continued from previous page)

that competition actually is excluded but that power exists to raise prices or to exclude competition when it is desired to do so").

6 The Commission has consistently "treat[ed] control of bottleneck facilities as prima facie evidence of market power[.]" First Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Servs. And Facilities Authorizations Therefor, 85 F.C.C.2d 1, 21 (1980); see also id. ("An important structural characteristic of the marketplace that confers market power upon a firm is the control of bottleneck facilities"); Memorandum Opinion, Order and Certificate, Application of Iowa Network Access Div. For Auth. Pursuant to Section 214 of the Communications Act of 1934 And Section 63.01 of the Comm'n's Rules and Regulations to Lease Transmission Facilities to Provide Access Serv. to Interexchange Carriers, 3 FCC Rcd. 1468, 1469 (1988) ("One of the indicia of market power is the control of bottleneck facilities, with a concomitant ability to impede competition").

7 Id., pp. 3-4.

facilities that currently can support high speed, two-way data communications for the vast majority of U.S. homes and business. Many rural customers, for example, do not have one-way communications services such as cable or satellite television, but almost all do have telephones that can be converted into advanced services pipelines. Cable and wireless technologies may eventually support affordable, ubiquitous alternatives to the local loop for many customers – and AT&T, for one, is investing heavily to that end – but today the incumbent LEC facilities used to provide advances services will remain bottleneck inputs for the provision of those services to most customers.[8]

Other incumbents claim in circular fashion that the availability of collocation space and unbundled loops eliminates their conceded "technical [and] economic advantages over new entrants in providing advanced services."[9] It is certainly true that nondiscriminatory access to loops and to collocation space are necessary pre-conditions to meaningful competition. But it

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[8] See, e.g., U S WEST, p. 3 (acknowledging that loops and collocation are "essential inputs"). Even if the ILECs' network facilities used to provide advanced services were not essential inputs, the Act would still mandate that they be provided to requesting carriers. As the Commission recently argued to the Supreme Court "the antitrust term 'essential facilities' does not appear anywhere in [the Act]. . . . As to most network elements, what the Commission must 'consider' is not whether the element is 'essential,' but whether deprivation of the element 'would impair the ability' of a requesting carrier 'to provide the services that it seeks to offer.'" FCC v. Iowa Utils. Bd., Reply Br. for the Federal Petitioners, p. 43 (filed June 17, 1998) (citing 47 U.S.C. 251(d)(2)(B)) (emphasis in original). In addition, the argument that advanced services-related equipment like packet switches are not essential elements because entrants can buy them from vendors (see, e.g., U S WEST, p. 8) ignores basic economics. That entrants can purchase their own local switches, for example, does not render the incumbent LEC's local switches unessential. See infra, Section V.

[9] U S WEST, p. 3.

is equally true that incumbents do not today provide these inputs on a nondiscriminatory basis.[10] One central purpose of this proceeding is to strengthen interconnection, collocation, and unbundling requirements to discourage this anticompetitive conduct. Both through their conduct and their attempts to evade any regulation of that conduct, the incumbents confirm the need for the requirements proposed by AT&T and others.

B. National Rules That Facilitate Nondiscriminatory Access to Collocation Space and Network Elements Will Enhance Advanced Services Innovation.

Relying on essentially the same arguments that the Commission rejected two years ago in the local competition proceeding, incumbents contend that robust unbundling and resale requirements will, by forcing incumbents to share their "innovations," create a disincentive for them to invest in the facilities needed to provide advanced services.[11] Precisely the opposite is true. As an initial matter, the incumbents' own actions belie their contention that the prospect of competition destroys their incentives to invest in advanced service facilities. "Five of the six largest ILECs are already [offering xDSL services directly], and three of those carriers either initiated or expanded their offerings after the NPRM was released[.]"[12]

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10 See, e.g., AT&T, pp. 13-15; MCI WorldCom, p. 79; MGC, pp. 39-44.

11 See, e.g., U S WEST, p. 9 ("Forced sharing of innovations indisputably undercuts the incentives for all market participants to invest, and thereby retards the deployment of advanced services").

12 Sprint, p. 36 (emphasis added).

The reality is that incumbents have been too slow to promote advanced services because of the absence of the potential competition that nondiscriminatory access to the facilities used to provide advanced services would bring. xDSL technology is not new. HDSL and ADSL were invented in the early 1990s,[13] but the first major incumbent initiatives to offer advanced services using these technologies have come only this year – and only after a CLEC or cable operator has announced its intention to provide a similar service in the ILEC's service territory. Incumbents "have clear incentives to slow-roll high-bandwidth local loop capabilities . . . because these facilities cannibalize their existing higher margin retail offerings."[14] In other words, when an incumbent offers xDSL services, it competes with itself by attracting customers

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13 The DSL Source Book: Plain Answers About Digital Subscriber Line Opportunities, 2d. pp. 12-19, "http://www.paradyne.com/sourcebook_offer/index.html."

14 Qwest, p. 71.

away from existing services such as ISDN, T1, and second lines to homes.[15] It is no surprise, then, that incumbents have been slow to offer xDSL services.[16]

For this reason, by mandating nondiscriminatory access to the facilities used to provide advanced services, the Commission will strengthen, not weaken, incumbent incentives to innovate. Unlike monopolists who are protected from competition, incumbents and other firms in markets open to competition have a tremendous incentive to innovate rapidly. They innovate in order to (i) obtain a temporary jump on their competitors and (ii) protect themselves from their competitors' innovations.

Both factors apply here. First, an incumbent in a competitive market can always obtain a valuable jump on its competitors by moving first. Although entrants may eventually lease the network elements necessary to provide a similar service or resell the incumbent's retail offering, the incumbent almost always will enjoy a first mover advantage. During that period,

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15 See also Ad Hoc, pp. 11-12 ("Given its potential to render their embedded circuit-switched networks obsolete, incumbents have little reason to embrace any policy that will speed the deployment of advanced services, and have every reason to resist policies that will diminish their control over the deployment of such services"); "Telco & Cable Internet Strategies: The Dawn of Carrier-class Access," 1997 Jupiter Strategic Planning Services/IT47, p. 31 ("Currently, the RBOCs have a stranglehold on high-speed Internet access via leased lines by virtue of their ownership of the local loop. The RBOCs will have little reason to invest in ADSL for business use until businesses have options for high-speed access besides leasing T1 and ISDN lines . . . . Moreover, high demand for second phone lines in the residential market – fueled in part by Internet access – provides a strong disincentive for RBOCs to offer ADSL to consumers, because ADSL offers simultaneous voice and data traffic").

16 See also Qwest, p. 18 ("ILECs are always reluctant to allow competitors to use their last mile facilities. That is the problem that required the Bell System divestiture. That is the problem that required Congress to enact Section 251 in the first place").

the incumbent not only will face no price competition but has the opportunity to build its reputation with customers as a leader in advanced services. Second, if incumbents facing competition do not innovate and offer high quality advanced services, their competitors will. An entrant could lease capable loops, deploy its own advanced services equipment in the incumbent's central office, and offer services that leapfrog the incumbent's basic services. Thus, with entry barriers reduced, incumbents gain both offensive and defensive incentives to innovate and move quickly.

In fact, the effect potential competition will have on incumbent behavior is already evident. Now that some CLECs and cable operators have announced their intentions to provide some advanced services, incumbents finally have begun offering xDSL services. This is precisely what happened when the incumbents were first threatened with competition for video dial tone. They began announcing commitments to offer such services, but as "the threat of cable company entry into telephony diminished over time . . . so did the ILECs' commitment to deploying [video dial tone]."[17] Nor has the ILECs' dismal history in deploying advanced services been restricted to video dial tone. ISDN was a working technology for 20 years before the ILECs made it widely available.[18] Here too, incumbent incentives to innovate will disappear if the Commission does not open local markets with additional unbundling and collocation

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17 Ad Hoc, p. 16.

18 See Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket No. 96-263, Comments of Internet Access Coalition, filed March 24, 1997, p. 23.

requirements. Hence, instead of rapidly innovating, incumbents will return to their historic practice of protecting their existing services by retarding the deployment of new ones. By contrast, "more competition in the provision of [advanced] services will only increase the urgency [the incumbents] feel to provide these services."[19]

Incumbents nonetheless complain that because competition will constrain their advanced services profits, it must necessarily constrain their incentives to innovate.[20] To the contrary, as the Commission, state commissions and federal courts have all agreed, forward-looking cost-based pricing of network elements, interconnection and collocation, by replicating competitive market outcomes, provides the correct economic incentives for both incumbents and

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19 Time Warner, p. 21.

20 See Ameritech, p. 8.

entrants.[21] The normal profits available in competitive markets provide a reasonable return to investors and strong incentives for efficient innovation.[22]

Nor is GTE's intellectual property protection analogy apt.[23] The intellectual property laws are designed to encourage firms and individuals to undertake research and development activities that may not produce profitable results for many years. For example,

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21 See, e.g., First Report & Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98 and 95-185, FCC 96-325 ¶ 672 (rel. August 8, 1996) ("Local Competition Order"); GTE South Inc. v. Morrison, 6 F. Supp. 2d. 517, 524 (E.D. Va. 1998); Southwestern Bell Tel. Co. v. AT&T Communications Inc., No.A 97-CA-132-SS, at p. 19 (W.D. Tex. Aug. 31, 1998); accord TNS, p. 7; CWI, p. 13. Under TELRIC or other forward-looking economic pricing arrangements, the ILECs will have similar incentives to invest as a competitive firm. See Local Competition Order ¶ 679 ("Adopting a pricing methodology based on forward-looking, economic costs best replicates, to the extent possible, the conditions of a competitive market."); id. ¶¶ 686-689. ILECs' claim (e.g., Ameritech, p. 8) that they do not have an incentive to invest under such compensation schemes is tantamount to claiming that no competitive firm ever has an incentive to invest.

22 The Commission should reject some ILECs' claim (e.g., Ameritech, p. 8) that TELRIC or other forms of forward-looking economic pricing are not fully compensatory and fail to provide investment incentives. First, the Commission has already concluded that TELRIC is fully compensatory and provides efficient investment signals for entrants and incumbents (see Local Competition Order ¶ 627, et seq.) and state commissions and federal district courts nationwide have echoed this finding. See also supra, n.21. Second, the ILECs' argument highlights their readiness to fault any reasonable pricing scheme. Since passage of the Act, ILECs have contended that they should be reimbursed for their "actual" or book costs. So long as they invest efficiently when deploying facilities to support advanced services, that is exactly what they will receive – plus a risk-adjusted rate of return on their investment. In other words, the forward-looking economic cost of efficient new investments should converge to the total book and capital costs of those investments so long as the ILECs are efficient. Thus, the ILECs' assertion that TELRIC is uncompensatory is nothing more than a thinly veiled attempt to protect their monopoly profits.

23 See, e.g., GTE, p. 107.